

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2013-59-E

IN RE:)	JOINT PROPOSED ORDER
Application of Duke Energy Carolinas, LLC)	APPROVING
for Authority to Adjust and Increase Its)	INCREASE IN RATES AND
Electric Rates and Charges)	CHARGES AND
)	SETTLEMENT AGREEMENT

I. INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (“Commission”) on the Application of Duke Energy Carolinas, LLC (“Duke” or the “Company”) filed March 18, 2013, (the “Application”) requesting authority to adjust and increase its electric rates, charges, and tariffs. The Application was filed pursuant to S.C. Code Ann. §§ 58-27-820, 58-27-870 (Supp. 2012) and 10 S.C. Code Ann. Regs. 103-303 and 103-823 (2012).

On March 18, 2013, along with its Application, the Company filed the direct testimony of Jeffrey R. Bailey, Director, Pricing and Analysis for Duke and its affiliated utility operating companies; Jeffrey A. Corbett, Senior Vice President, Carolinas Delivery Operations for Duke Energy Corporation’s (“Duke Energy”) Regulated Utilities Operations, including Duke; Clark Sutton Gillespy, President of Duke for South Carolina; Robert B. Hevert, Managing Partner of Sussex Economic Advisors, LLC; Janet A. Jones, Lead Rates Analyst, State Support, Regulatory Strategy & Research for Duke Energy Business Services, LLC (“DEBS”); Jane L. McManeus, Managing Director, Rates for Duke; Joseph A. Miller, Jr., Director of Strategic Engineering for DEBS; John William (“Bill”) Pitesa, Chief Nuclear Officer for DEBS; Carol E. Shrum, Director,

Rates and Regulatory Strategy – Duke; and, J. Danny Wiles, Director of Regulated Accounting for DEBS. Exhibits were included with the direct testimony of witnesses Bailey, Hevert, McManeus, Shrum, and Wiles.¹

The Commission last approved the Company's general electric rates and charges in Order No. 2012-77, Docket No. 2011-271-E, which allowed the Company a return on equity ("ROE") of 10.50%. In this Application, the Company requested a revenue increase of approximately \$220 million and an ROE of 11.25%.

On March 26, 2013, the Commission's Docketing Department issued a testimony schedule and on April 3, 2013, the Docketing Department instructed the Company to publish a Notice of Filing and Hearing in newspapers of general circulation in the areas affected by the Company's Application by May 12, 2013. The Notice of Filing and Hearing indicated the nature of the Company's Application and advised those desiring to participate in the evidentiary hearing, scheduled to begin July 31, 2013, of the manner and time in which to file appropriate pleadings. The Company was also instructed to notify each affected customer of the hearing by May 13, 2013, and provide a certification to the Commission by June 3, 2013. On May 20, 2013, and May 31, 2013, the Company filed affidavits with the Commission demonstrating that the Notice was duly published in accordance with the Docketing Department's instructions.

Pursuant to Commission Order Nos. 2013-250, 2013-271 and 2013-483², the Docketing Department scheduled public night hearings in the counties of Greenville, Spartanburg,

¹ Composite Hearing Exhibit 15 consists of the Direct Testimony Exhibits Bailey 1 through 7 of Jeffrey R. Bailey; Composite Hearing Exhibit 10 consists of the Direct Testimony Exhibits RBH 1 through 6 of Robert B. Hevert; Hearing Exhibit 12 consists of the Direct Testimony Exhibit McManeus 1 of Jane L. McManeus; Hearing Exhibit 13 consists of the Direct Testimony Exhibit Shrum 1 of Carol E. Shrum; and, Composite Hearing Exhibit 14 consists of the Direct Testimony Exhibits Wiles 1 through 4 of J. Danny Wiles.

² The purpose of the night hearings was to provide a forum, at a convenient time and location, for customers of Duke to present their comments regarding the service and rates.

Anderson, Richland, and York. On April 29, 2013 and July 2, 2013, the Commission's Docketing Department instructed the Company to notify each affected customer of the Public Night Hearings by May 30, 2013 and July 10, 2013. On June 5, 2013 and July 23, 2013, the Company filed affidavits demonstrating that these Notices of Public Hearings were duly published in accordance with the Commission's Docketing Department's instructions.

The South Carolina Energy Users Committee ("SCEUC") represented by Scott Elliott, Esquire, filed a petition to intervene on March 28, 2013. The South Carolina Small Business Chamber of Commerce ("SB Chamber") represented by John J. Fantry, Jr., Esquire, filed a petition to intervene on April 8, 2013. Wal-Mart Stores East, LP and Sam's East, Incorporated (collectively referred to as "Walmart") represented by Stephanie U. Roberts, Esquire, and Derrick Price Williamson, Esquire, filed a petition to intervene on April 11, 2013. The Commission of Public Works of the City of Spartanburg South Carolina and Spartanburg Sanitary Sewer District (collectively referred to as "Spartanburg Water") represented by Richard L. Whitt, Esquire filed a petition to intervene on May 15, 2013. The South Carolina Office of Regulatory Staff ("ORS"), automatically a party pursuant to S.C. Code Ann. § 58-4-10(B) (Supp. 2012), was represented by C. Dukes Scott, Esquire, Shannon Bowyer Hudson, Esquire, and Courtney D. Edwards, Esquire. Duke was represented by Heather S. Smith, Esquire, Charles A. Castle, Esquire, Timika Shafeek-Horton, Esquire, and Frank R. Ellerbe, III, Esquire,.

On June 28, 2013, the SB Chamber filed the direct testimony of Frank Knapp, Jr, President and CEO of SB Chamber. On July 1, 2013, Walmart filed direct testimony and exhibits of Steve W. Chriss, Senior Manager, Energy Regulatory Analysis, for Wal-Mart Stores,

Inc.³; SCEUC filed the direct testimony and exhibits of Kevin W. O'Donnell, President of Nova Energy Consultants, Inc.⁴; Spartanburg Water filed the direct testimony of G. Newton Pressley, Deputy General Manager of Finance and Administration, and Sidney Kenneth Tuck, Jr., Director of Water Treatment; and ORS filed the direct testimony of Joseph W. Coates, Auditor; Leigh C. Ford, Senior Electric Utilities Specialist in the Electric Department; Robert A. Lawyer, Audit Manager; Arnold K. Owino, Auditor (adopted by Robert A. Lawyer); Michael L. Seaman-Huynh, Senior Electric Utilities Specialist in the Electric Department; and, Lynda Sleighter Shafer, Electric Utilities Specialist in the Electric Department. Exhibits were included with the direct testimony of witnesses Lawyer and Seaman-Huynh. ORS filed revised direct testimony and exhibits of witness Seaman-Huynh on July 8, 2013, and Revised Audit Exhibit RAL-5 to the direct testimony of witness Lawyer on July 12, 2013.⁵

On July 1, 2013, SB Chamber, Walmart, Spartanburg Water, Duke, and ORS filed a Stipulation ("Stipulation") agreeing to an ROE of 10.20%.

In Order No. 2013-466, issued on July 3, 2013, the Commission granted the Company's request for leave to file the direct testimony of Dhiaa M. Jamil, which would adopt the pre-filed direct testimony of Bill Pitesa. On July 9, 2013, the Company filed Stipulation supporting and rebuttal testimony of Company witness Gillespy; rebuttal testimony of Company witnesses Bailey and Shrum; and, ROE Stipulation support and rebuttal testimony and exhibits of

³ Composite Hearing Exhibit 18 consists of the Direct Testimony Exhibits SWC 1 through 4 of Steve W. Chriss.

⁴ Composite Hearing Exhibit 16 consists of the Direct Testimony Exhibits KWO 1 through 4 of Kevin W. O'Donnell.

⁵ Composite Hearing Exhibit 19 consists of the Direct Testimony Exhibits RAL 1 through 7 (including Revised Audit Exhibit RAL-5) of Robert A. Lawyer and Composite Hearing Exhibit 20 consists of the Revised Direct Testimony Exhibits MSH 1 through 3 of Michael L. Seaman-Huynh.

Company witness Hevert.⁶ Surrebuttal testimony and exhibits were filed by SCEUC witness O'Donnell on July 16, 2013.⁷

On July 23, 2013, ORS filed a Settlement Agreement and Attachments A, B, and C ("Settlement Agreement") on behalf of all Parties in this Docket: SB Chamber, Walmart, SCEUC, Spartanburg, Duke, and ORS (collectively referred to as the "Settling Parties"), which adopts the Stipulation. Settlement Agreement Attachment A reflects the Company's operating experience, accounting adjustments and the increase in annual revenues from base rates of approximately \$118,622,000. Settlement Agreement Attachment B shows the levelization of the incremental nuclear generation outage costs and describes the corresponding accounting treatment for such expenses. Settlement Agreement Attachment C shows, by customer class, the allocation of the increase in revenues and the respective rates of return by customer class. On July 23, 2013, Duke filed settlement testimony of witnesses Gillespy and Shrum and ORS filed settlement testimony of witness Ford.

Public hearings were held on June 20, 2013 in Spartanburg; June 24, 2013 in Greenville; June 27, 2013 in Anderson; August 1, 2013 in Columbia; and August 15, 2013 in York.⁸

The Commission conducted an evidentiary hearing on this matter on July 31, 2013 in the hearing room of the Commission with the Honorable G. O'Neal Hamilton presiding. At the outset of the hearing, ORS counsel described the Settlement Agreement. The Stipulation and

⁶ Composite Hearing Exhibit 11 consists of the Rebuttal Testimony Exhibits RBH 1 through 8 of Robert B. Hevert.

⁷ Composite Hearing Exhibit 17 consists of the Surrebuttal Testimony Exhibits KWO 1 through 3 of Kevin W. O'Donnell.

⁸ Hearing Exhibit 1 consists of the Spartanburg Night Hearing sign-in sheets; Hearing Exhibit 2 consists of Petition(s) from public witness Powell; Hearing Exhibit 3 consists of billing data submitted by public witness Williams; Hearing Exhibit 4 consists of submitted materials by public witness Unkefer; Hearing Exhibit 5 consists of submitted NAACP Petition(s) by public witness Flemming; Hearing Exhibit 6 consists of the Greenville Night Hearing sign-in sheets; Hearing Exhibit 7 consists of the Anderson Night Hearing sign-in sheets; Hearing Exhibit 8 consists of submitted materials by public witness Myers; Hearing Exhibit 22 consists of the typed statement of public witness Riggan; Hearing Exhibit 23 consists of the Columbia Night Hearing sign-in sheets; Hearing Exhibit 24 consists of the Rock Hill Night Hearing sign-in sheets; and, Hearing Exhibit 25 consists of Charles Harbin's testimony.

Settlement Agreement, including its Attachments A, B and C, were accepted into the record as composite Hearing Exhibit 9. The Settlement Agreement is attached as Order Exhibit No. 1 and incorporated herein by reference. Prior to the hearing, the Commission granted Duke and ORS permission to utilize panels for the presentation of witnesses.

Duke witnesses Gillespy, Jamil, Miller, Corbett, Hevert, McManeus, Shrum, Wiles, Jones, and Bailey; SB Chamber witness Knapp; Walmart witness Chriss; and ORS witnesses Coates, Lawyer, Seaman-Huynh, Shafer and Ford appeared, gave summaries of their testimonies, and answered questions from the Commission. The Commission allowed Spartanburg Water's and SCEUC's witnesses to be excused from appearing at the hearing.

Duke witness Gillespy provided an overview of the reasons for the Company's request for an increase in electric rates and charges and the ongoing system modernization efforts. Witness Jamil described the Company's fleet modernization program and other capital additions since the Company's last general rate case in 2011 and operational performance of Duke's nuclear, fossil, hydroelectric, and renewable generation portfolio during the test period ending June 30, 2012. Duke's first panel of witnesses, which consisted of Miller and Corbett, discussed Duke's generation portfolio, electric transmission, and distribution. Witness Hevert addressed the Company's financial objectives, capital structure and cost of capital. Company witness McManeus testified to the fuel component of proposed base rates for all customer classes. Duke's second panel, witnesses Shrum and Wiles, described the Company's accounting requests for levelization of expenses related to nuclear outages, end-of-life nuclear expenses, deferrals proposed for the Nuclear Regulatory Commission's ("NRC") mandated Tornado/High Energy Line Break ("HELB") work at Oconee Nuclear Station ("Oconee"), and the Fukushima and

cyber security costs.⁹ Duke's third panel, witnesses Jones and Bailey, addressed customer class allocation and rate design.

SB Chamber witness Knapp and Walmart witness Chriss testified in support of the Settlement Agreement.

ORS presented its first panel of witnesses which consisted of witnesses Coates and Lawyer. They each provided a summary of their testimony and explained the findings and recommendations as reflected in the ORS Audit Exhibits resulting from ORS' examination of Duke's Application and supporting books and records. Witnesses Seaman-Huynh, Shafer and Ford testified as ORS's second panel with each providing a summary and review of the ORS Electric Department's examination of the Company's Application.

Proposed orders were due on September 6, 2013.

II. FINDINGS OF FACT

Based upon the Application, the Stipulation, the Settlement Agreement, the testimony, and exhibits received into evidence at the hearing and the entire record of these proceedings, the Commission makes the following findings of fact:

A. JURISDICTION

1. Duke is a limited liability company duly organized and existing under the laws of the State of North Carolina. It is a public utility under the laws of the State of South Carolina and is subject to the jurisdiction of this Commission pursuant to S.C. Code Ann. § 58-3-140(A) (Supp. 2012). The Company is engaged in the business of generating, transmitting, distributing, and selling electric power to the public in western South Carolina and a broad area of central and

⁹ Hearing Exhibit 21 consists of a late-filed exhibit requested by Commissioner Fleming for a listing by executive officer, showing total compensation included in case and the percentage of total compensation.

western North Carolina. Duke is a wholly-owned subsidiary of Duke Energy, both having their offices and principal places of business in Charlotte, North Carolina.

2. The Commission has jurisdiction over the rates and charges, rate schedules, classifications, and practices of public utilities operating in South Carolina, including Duke, as generally provided in S.C. Code Ann. §§ 58-27-10, *et seq.* (1976 & Supp. 2012).

3. Duke is lawfully before the Commission based upon its Application for a general increase in its retail rates pursuant to S.C. Code Ann. §§ 58-27-820, 58-27-870, and 10 S.C. Code Ann. Regs. 103-303 and 103-823 (2012).

4. The appropriate test period for use in this proceeding is the twelve (12) months ended June 30, 2012.

B. STIPULATION AND SETTLEMENT AGREEMENT

5. Duke, by its Application and initial direct testimony and exhibits, originally sought an increase of approximately \$220 million or 15.13% in its annual electric sales revenues from South Carolina retail electric operations, and an ROE of 11.25%.

6. Duke submitted evidence in this case with respect to revenue, expenses and rate base using a test period consisting of the twelve (12) months ended June 30, 2012. The Settlement Agreement is based upon the same test period.

7. On July 1, 2013, ORS filed the Stipulation, on behalf of SB Chamber, Walmart, Spartanburg Water, Duke, and ORS agreeing to an ROE of 10.20%.

8. On July 23, 2013, ORS filed the Settlement Agreement, on behalf of the Settling Parties.

9. The Settlement Agreement provides for a revenue increase implemented incrementally over a two year period of approximately \$118,622,000 which equates to a reduction of approximately \$101.4 million or 46% from the Application.

10. The Settling Parties agree to a two-year incremental rate increase which would increase revenues in the first year by \$80,391,000 or 5.53% and in the second year and beyond by an additional \$38,230,992 or 2.63%. For the two-year incremental rate increase, rates would become effective no earlier than September 18, 2013 for the first year and September 18, 2014 for the second year, or as ordered by the Commission.

11. The Settling Parties agree to accept, for purposes of the Settlement Agreement, all proposals and recommendations put forth in Settlement Agreement Attachments A and C.

12. The Settling Parties agree that to help mitigate the impact of the rate increase, while allowing the appropriate revenue recovery, the Company will remove \$45 million from the current Cost of Removal Reserve and use the \$45 million to offset the first year of the rate increase and excess coal inventory revenues addressed below, thereby creating a two-year incremental increase in rates. The Cost of Removal Reserve is a reserve that is to be used to offset the cost to remove Company assets when these assets are retired. Contributions are made to this reserve based on the Company's depreciation study and reflect the estimated amount needed to properly remove these assets from service.

13. The Settling Parties agree that the cost of the Company's coal will be recovered once the coal is burned and verified as part of the Company's annual fuel review. However, instead of adding the excess inventory to rate base, the Company will be allowed to earn a return on the excess inventory similar to the accounting treatment of a rate base item. The return would

be calculated based on the Company's cost of capital established in this Docket. The Company would earn a return in the amount of \$6,769,000 on the excess inventory for one (1) year effective with any new rates that are approved by the Commission in this proceeding. Because these funds are in addition to the proposed increase in this Docket, the \$6,769,000 is being offset by funds from the Cost of Removal Reserve.

14. Duke has agreed that it shall not seek an increase in its retail base rates and charges to be effective prior to September 18, 2015, except for those approved as part of the Company's Demand Side Management ("DSM") rate rider and Energy Efficiency ("EE") programs, or rates approved under Section 58-27-865, or the provisions of Article 4 of Chapter 33 of Title 58, or except where necessary due to unforeseen extraordinary economic or financial conditions.

15. The Company has agreed to make, at shareholder expense, a one-time contribution in the amount of \$3.5 million. The \$3.5 million contribution will be allocated as follows: (1) \$1 million will be used under the direction of ORS to support public education initiatives and senior outreach, and (2) \$2.5 million will be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs.

16. As provided in Settlement Agreement Attachment B, the Company may use levelization accounting for nuclear refueling costs. The Company may begin using such accounting effective October 1, 2013. The Commission finds and concludes that this provision of the Settlement Agreement is just and reasonable to all Settling Parties in light of all the evidence presented.

17. The Settling Parties agree that the \$118,622,000 revenue increase will be allocated among the rates and customer classes as shown in Attachment C to the Settlement Agreement. Attachment C sets forth the proposed rate increases by rate schedule, as well as the respective rates of return by customer class. The Settling Parties agree that the proposed allocations reflected in Attachment C to the Settlement Agreement are just and reasonable and represent an appropriate reduction in this proceeding to interclass rate subsidies.

18. The Commission, having carefully reviewed the Settlement Agreement and all of the evidence of record, finds and concludes that the provisions of the Settlement Agreement are just and reasonable as to all the Parties, are in the public interest, and should be approved in their entirety. The specific terms of the Settlement Agreement are addressed in the following findings of fact and conclusions.

III. EVIDENCE AND CONCLUSIONS

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 1 THROUGH 4

Duke is an electric utility subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. Sections 58-3-140(A) (Supp. 2012). South Carolina uses a historic twelve-month test period. 10 S.C. Code Ann. Regs. 103-823(A)(3) (2012). These findings and conclusions are informational, procedural and jurisdictional in nature and are not contested by any of the Parties.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 5 THROUGH 14

The Commission last approved the Company's general electric rates and tariffs in Order No. 2012-77, Docket No. 2011-271-E, which allowed the Company a 10.50% ROE. The test period in that case was the twelve (12) months ended December 31, 2010.

On March 18, 2013, Duke filed its Application and initial direct testimony and exhibits, seeking an increase of approximately \$220 million or 15.13% in its annual electric sales revenues from South Carolina retail electric operations and an ROE of 11.25%.

Duke submitted evidence in this case with respect to revenue, expenses and rate base using a test period consisting of the twelve (12) months ended June 30, 2012. The Settlement Agreement is based upon the same test period.

The Settlement Agreement filed on July 23, 2013 provides for an increase of approximately \$118,622,000 or 8.16% in Duke's annual revenues from energy sales to its South Carolina retail electric operations. The Settlement Agreement increases revenues in the first year by \$80,391,000 or 5.53% and in the second year and beyond by an additional \$38,230,922 or 2.63%. Rates would become effective no earlier than September 18, 2013 for the first year and September 18, 2014 for the second year. Duke will not seek another increase in its South Carolina retail base rates and charges to be effective prior to September 18, 2015, except for those approved as part of the Company's DSM rate rider and Energy Efficiency programs, or rates approved under Section 58-27-865, or the provisions of Article 4 of Chapter 33 of Title 58, or except where necessary due to unforeseen extraordinary economic or financial conditions.

a) Need for Rate Increase

Company witness Gillespy testified that the rate case is driven by the \$3.3 billion of capital invested in projects, including the modernization program that consists of retiring, replacing and/or upgrading generation plants and transmission and distribution systems. These projects are needed to provide safe, reliable and environmentally compliant electricity at reasonable costs.

On a South Carolina jurisdictional basis, Duke's gross rate base additions include new plant additions of approximately \$63 million for the Cliffside Unit 6 coal plant, \$160 million for the Dan River Combined Cycle Plant ("Dan River"), \$32 million for the McGuire Nuclear Station Uprate Project ("McGuire"), and \$29 million for the NRC mandated Tornado/HELB work at Oconee. Duke's gross rate base additions also include \$504 million spent to maintain, upgrade, and modernize its existing generating plants as well as the transmission and distribution power delivery systems and other general and intangible assets necessary to maintain and operate the Company's system. Including cost of capital, depreciation and property taxes, gross plant additions to the generation and power delivery systems translate into approximately \$120 million of additional annual revenue requirements on a South Carolina jurisdictional basis.

The need to modernize the system is also driven by environmental compliance requirements such as the need for emission controls to comply with a series of new proposed United States Environmental Protection Agency ("EPA") rules regulating multiple areas relating to generation resources, such as mercury, sulfur dioxide, nitrogen oxide, coal combustion by-products and fish impingement/entrainment. These new EPA rules, if implemented, will increase the need for the installation of additional environmental control technology or retirement of coal fired generation in the 2014 to 2018 timeframe.

Witness Jamil testified that since the 2011 Rate Case, the Company has spent over \$995 million in capital additions to plant in-service and additional CWIP for the nuclear fleet. Duke's nuclear generation fleet consists of three (3) generating stations; Oconee, McGuire and Catawba, which provide approximately 5,200 megawatts of capacity. The nuclear fleet performed well during the test period with an average capacity factor of over 95%. As part of the modernization

program, the Company has undertaken upgrades for digital systems, improved water management systems, upgraded protection against severe natural phenomenon events, and enhanced safety and security in and around the Company's nuclear facilities as well as other reliability and efficiency improvements. Additionally, witness Jamil discussed the deferrals for two (2) projects: (1) the NRC-mandated Tornado/HELB project at Oconee; and, (2) uprate related projects at McGuire. Lastly, he testified that the primary drivers for Operations & Maintenance ("O&M") expenses within the nuclear fleet are increased regulatory requirements involving safety and security; rising costs for labor, material and supplies; cybersecurity; and in response to the events at Fukushima.

Company witness Miller testified that Duke's generation portfolio consists of approximately 15,000 megawatts of fossil/hydro and renewable generation capacity. Miller also provided testimony on the Company's requested deferral of post in-service costs for Cliffside Unit 6 and Dan River. As part of the Company's fleet modernization plan, the Company also included the retirement of several of its older coal-fired units, including Buck Units 5 and 6, and Riverbend Units 4 through 7. Other capital projects included in the Company's rate request are associated with replacement of boiler components, environmental control equipment, material handling functions, hydro relicensing efforts, and hot gas path inspections at combustion turbine sites. The Company's O&M expenses are comprised of both fuel and non-fuel items. For fossil units, approximately 83% of O&M expenses for the test period are fuel-related. The majority of the non-fuel expenditures are for labor, materials and contract services required for O&M activities.

Witness Corbett testified that Duke's Transmission and Distribution ("T&D") system delivers electric service to approximately 540,000 South Carolina retail customers. The Company's combined distribution system is comprised of approximately 66,600 miles of overhead distribution lines and 35,300 miles of underground distribution lines. The T&D system includes 177 transmission substations and 1,442 distribution and industrial substations with a combined capacity of approximately 55 million Kilo-Volt-Ampere. Since 2011, the Company has added approximately \$794 million to electric plant in service and additional CWIP for T&D systems. The major categories for these expenditures include reliability, customer additions, capacity, and infrastructure. Over the 2010 Test Period, Transmission O&M costs increased by approximately 8.7%. This increase is associated with the Facilities Rating Project mandated in 2010 by the North American Electric Reliability Corporation requiring verification of the operational ratings of transmission facilities based on actual field conditions. The project began in 2011 and will conclude in 2014.

SB Chamber witness Knapp addressed Duke's requested revenue increase; revenue allocation method; and DSM and EE programs. Walmart witness Chriss addressed issues relating to Duke's requested revenue requirement and revenue allocation. SCEUC witness O'Donnell addressed ROE, capital structure, cost of service and rate design; and various accounting adjustments. Spartanburg Water witnesses Pressley and Tuck addressed the impact and effect of Rate Schedule MP.

Subsequent to filing testimony, SB Chamber, Walmart, SCEUC and Spartanburg Water agreed to the terms of the Settlement Agreement.

ORS witnesses Coates and Lawyer testified to ORS's proposed Accounting and Pro Forma Adjustments resulting from ORS's examination of the Company's Application. ORS witnesses Seaman-Huynh, Shafer, and Ford testified to the cost of service, depreciation rates, rate design, and ORS recommendations and pro forma adjustments such as: rate case expenses; connection charge; customer growth; coal inventory levels; extra facilities revenues; end-of-life nuclear costs; vegetation management; storm restoration costs; O&M labor costs; increased benefits expenses; a Clemson research grant; deferred amounts and expenses relating to Buck, Bridgewater, Cliffside 6, Dan River, McGuire, and Oconee projects; officer compensation; Board of Directors' fees; and decommissioning expenses.

b) Rate of Return

Pursuant to the Settlement Agreement, the Company will have the opportunity to earn an overall rate of return of 7.89% on its South Carolina retail jurisdictional rate base of \$4,228,964,000 and an allowed return of 10.20% on the equity component of a target capital structure comprised of 47% long-term debt and 53% equity.

(1) Capital Structure

Duke witness Gillespy testified that the Settlement Agreement reflects a constructive approach to providing necessary rate relief that will allow the Company the opportunity to maintain its financial strength and credit quality and enable it to continue to provide reliable, increasingly clean electricity at a reasonable cost for customers.

Company witness Hevert testified that a return that is adequate to attract capital at reasonable terms, under varying market conditions, will enable the subject utility to provide safe, reliable electric service while maintaining its financial integrity. While the "capital attraction"

and “financial integrity” standards are important principles in normal economic conditions, the practical implications of those standards are even more pronounced when, as with Duke, the subject company has substantial capital expenditure plans. Sustained increases in the incremental spread on utility debt (*i.e.*, the difference in debt yields of utilities’ varying credit ratings) has intensified the importance of maintaining a strong financial profile; since the incremental cost of a downgrade in bond rating is more expensive now than it historically has been. Therefore, preserving Duke’s current credit profile is an important consideration in enabling the Company to access the capital markets, as needed, at reasonable cost rates.

According to the “Quarterly Financial Report for the twelve months ending March 31, 2013,” filed with the Commission in Docket No. 2006-268-E, Duke’s capital structure was 45.13% long-term debt and 54.87% equity. In its Application, Duke applied a target capital structure of 47% debt and 53% equity.

Witness Hevert explained that capital structure is an important component of credit quality and that the 53% equity ratio proposed by the Company will help enable access to capital at reasonable rates. The Company maintains its equity ratio at that level as part of its continuing efforts to maintain its financial profile and credit ratings. If the Commission were to approve a lower equity ratio, Duke either would reduce its actual equity ratio, which would have the effect of increasing its financial risk, or risk the dilution of its income and cash flow-based credit metrics. In either case, the Company’s financial profile likely would come under pressure.

Witness Hevert testified that Duke’s equity component enables it to maintain its current credit ratings, financial strength and flexibility. Duke Energy’s senior unsecured credit ratings are BBB, Baa2, and BBB+ from Standard & Poor’s (“S&P”), Moody’s Investors Service

("Moody's"), and Fitch Ratings ("Fitch") respectively. Duke's senior unsecured credit ratings are BBB+ (S&P), A3 (Moody's), and A (Fitch).

Based on the testimony provided by witnesses Gillespy, Jamil, and Hevert, the Commission recognizes the Company's need to raise capital. The Commission recognizes that, as discussed by witness Hevert, a strong equity component is a factor in determining the Company's credit rating. The target capital structure of 47% debt and 53% equity is appropriate for the Company in this proceeding. The debt/equity ratio is consistent with the average the Company has maintained for the last decade. Accordingly, the Commission finds and concludes that the target capital structure of 47% debt and 53% equity is just and reasonable in light of all the evidence presented.

(2) Return on Equity

In setting rates, the Commission must determine a fair rate of return that the utility should be allowed the opportunity to earn after recovery of the expenses of utility operations. The legal standards applicable to this determination are set forth in Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602-603 (1944) and Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm'n of W. Va., 262 U.S. 679, 692-93 (1923). These standards were adopted by the South Carolina Supreme Court in Southern Bell Tel. & Tel. Co. v. S.C. Pub. Serv. Comm'n, 270 S.C. 590, 595-96, 244 S.E.2d 278, 281 (1978). The Court stated:

What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or

anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties...

Southern Bell Tel., 270 S.C. at 595-96, 244 S.E.2d at 281 (quoting Bluefield, 262 U.S. at 692-93). These cases also establish that the process of determining rates of return requires the exercise of informed judgment by the Commission. The South Carolina Supreme Court has held that:

[T]he Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its ratemaking function, moreover, involves the making of 'pragmatic adjustments' Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. . . . The ratemaking process under the Act, *i.e.*, the fixing of 'just and reasonable' rates, involves the balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case that 'regulation does not insure that the business shall produce net revenues.' . . . [B]ut such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Southern Bell Tel., 270 S.C. at 596-97, 244 S.E. 2d at 281 (quoting Hope Natural Gas Co., 320 U.S. at 602-03). These principles have been employed by the Commission and the South Carolina Courts consistently.

Witness Hevert initially recommended an ROE of 11.25%, as stated in the Company's Application, which took into consideration the Discounted Cash Flow ("DCF") model, the Capital Asset Pricing Model and the following: (1) the Company's growing customer base, (2)

more stringent environmental regulations for coal-fired generation, (3) increased regulatory mandates for nuclear generation, and (4) flotation costs associated with capital raised through equity issuances. Witness Hevert indicated that although the 10.20% ROE included in the Settlement Agreement was below the low end of his recommended range and below his specific recommendation; it was within the range of the mean analytical results presented in his Rebuttal Testimony, in particular the DCF models. In the context of the Settlement Agreement, taken in its entirety, witness Hevert testified that the 10.20% ROE would be appropriate to support the Company's ability to access the capital markets at reasonable rates.

In considering the appropriate ROE for Duke, the Commission reviewed the methodologies and conclusions of the witnesses who employed numerical models to calculate the ROE for the Company, considered the evidence related to market conditions and investor expectations, and reviewed the evidence in support of the ROE proposed in the Settlement Agreement. The Commission does not believe that a utility's investments in plant additions should be viewed as a long-term drag on earnings since regulated electric utilities may recover the costs of these investments and earn a return on them.

The Settlement Agreement ROE of 10.20% supports the Company's credit profile and maintains the Company's ability to access the capital markets at reasonable rates. The 10.20% ROE is also supported by the analytical results presented in testimony by Duke witness Hevert. The Commission concludes that the Settling Parties' recommended ROE of 10.20% is just and reasonable and in the public interest.

(3) Rate Base and Revenue Increase

The South Carolina Supreme Court has defined *rate base* as “the amount of investment on which a regulated public utility is entitled to an opportunity to earn a fair and reasonable return; and represents the total investment in, or the fair value of, the used and useful property which it necessarily devotes to rendering the regulated services.” Hamm v. Pub. Serv. Comm’n, 309 S.C. 282, 286, 422 S.E.2d 110, 112 (1992) (citing Southern Bell Tel., 270 S.C. at 600, 244 S.E.2d at 283). “Rate base should reflect the actual investment by investors in the Company’s property and value upon which stockholders will receive a return on their investment.” Parker v. S.C. Pub. Serv. Comm’n, 280 S.C. 310, 312, 313 S.E.2d 290, 292 (1984). The Commission has the statutory authority after hearing to “ascertain and fix the value of the whole or any part” of Duke’s rate base, and may “ascertain the value of all new construction, extensions and additions” to such property. S.C. Code Ann. § 58-27-180 (Supp. 2012).

With regard to the accounting adjustments, the South Carolina Supreme Court has concluded that adjustments to the test year should be made for any known and measureable out-of-period changes in expenses, revenues, and investments that would materially alter the rate base. “The object of the test year is to reflect typical conditions. Where an unusual situation exists which shows that the test year figures are atypical the [Commission] should adjust the test year data. Any other standard would negate the aspect of finality created by a test year time limitation.” Parker, 280 S.C. at 312, 313 S.E.2d at 292.

Duke, by its Application and initial direct testimony and exhibits, originally sought an increase of \$220 million or 15.13%, from its South Carolina retail electric operations. The

Settlement Agreement provides for an increase of approximately \$118,622,000 in base rates or 8.16%, when compared to adjusted test year revenues.

ORS conducted an examination of the Company's Application and supporting books and records including rate base items. On the basis of this examination, hearing exhibits and testimony, the Commission can determine and find proper balances for the components of the Company's rate base, as well as the propriety of related accounting adjustments. The Commission determines the appropriate rate base, as adjusted, for the test period. This practice enhances the timeliness of the effect of such action and preserves the reliance on historic and verifiable accounts without resorting to speculative or projected figures. The Commission finds it reasonable to continue this regulatory practice and uses a rate base, as adjusted, for the test period ending June 30, 2012, in this proceeding.

ORS filed direct testimony applying several adjustments to conclude that a South Carolina retail electric rate base of \$4,228,978,000 was appropriate. Settlement Agreement Attachment A shows Duke's operating experience, rate base and rate of return for Total Company Per Books and South Carolina retail operations, excluding Greenwood County Electric Power Commission ("Greenwood") for the test year.¹⁰

ORS witness Lawyer testified that ORS verified total (North Carolina and South Carolina) electric operating revenues of \$6,427,996,000, total operating expenses of \$5,272,692,000 and net operating income for return of \$1,155,304,000. Total electric rate base was \$16,617,516,000. Witness Lawyer also explained the allocation to South Carolina Retail Per Books of a net operating income for return of \$258,640,000 and total rate base of

¹⁰ The revenue and cost of service related to the Greenwood County Electric Power Commission are excluded pursuant to S.C. General Assembly Act 1293 of 1966 and Duke Power Co. v. S.C. Pub. Serv. Comm'n, 284 S.C. 81, 326 S.E.2d 395 (1985).

\$3,852,798,000, resulting in a rate of return of 6.71%, and a return on common equity of 7.98%, as reflected in Hearing Exhibit 19. ORS witnesses Coates and Lawyer explained ORS' proposed Accounting and Pro Forma Adjustments which were subsequently incorporated into Settlement Agreement Attachment A, Hearing Exhibit 9.

Pursuant to the Settlement Agreement Attachment A, the Settling Parties agreed upon operating revenues of \$1,606,544,000, operating expenses of \$1,274,469,000, customer growth of \$1,593,000, and original cost rate base of \$4,228,964,000 for South Carolina excluding Greenwood. As Duke witness Hevert testified, the Settlement Agreement will provide the Company with the opportunity to earn an overall ROE of 10.20% on a target capital structure based upon 47% long-term debt and 53% equity.

Based on the Settlement Agreement's provisions, testimony and exhibits of all the Parties, the Commission finds and concludes that approximately a \$118,622,000 increase in the level of base rates for Duke's South Carolina retail customers, is appropriate and that an overall rate of return of 7.89% on South Carolina retail jurisdictional rate base and an ROE of 10.20%, is just and reasonable in light of the substantial evidence in the record.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 15

The Settling Parties agree that Duke shall make, at shareholder expense, a one-time contribution in the amount of \$3.5 million. The \$3.5 million contribution will be allocated as follows: (1) \$1 million will be used under the direction of ORS to support public education initiatives and senior outreach, and (2) \$2.5 million will be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs. After hearing the testimony of Lt. Governor

Glenn F. McConnell and ORS witness Ford, the Commission finds that the one-time contribution in the amount of \$1 million should be used to support public education initiatives and senior outreach and \$2.5 million should be used to support Share the Warmth and public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs. These contributions will continue to balance the concerns of ratepayers, the financial integrity of the Company and further economic development in South Carolina. The Commission finds that the one-time contribution, set forth in the Settlement Agreement, is just and reasonable, and supported by the evidence in the record.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 16

Company witness Shrum explained that Duke included in its Application a request for approval to implement a levelization methodology for its nuclear unit refueling outage expenses. As explained in the Settlement Testimony of Company witness Shrum, in order to minimize the impact of the variability and to appropriately align the refueling outage expenses with the period over which customers receive the benefit of the fuel cycle, the Company proposed to levelize the expenses associated with these refueling outages by deferring and amortizing them over the period between scheduled refueling outages. The Settlement Testimony of Company witness Shrum explains the accounting treatment and rate recovery of the outage deferrals in great detail, and Settlement Agreement Attachment B shows the levelization of the incremental nuclear generation outage costs and describes the corresponding accounting and rate treatment for such expenses. This provision provides that the Company may use levelization accounting for nuclear refueling costs, effective October 1, 2013. The Commission finds and concludes that this

provision of the Settlement Agreement is just and reasonable to all Settling Parties in light of all the evidence presented.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 17-18

Under South Carolina law, the Commission is vested with the authority to fix just and reasonable utility rates. S.C. Code Ann. §§ 58-3-140, 58-27-810 (1976 & Supp. 2012). Under this statute, the Commission has traditionally adhered to the following principles:

(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost-apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or customer-rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between cost incurred and benefits received.

Bonbright, Principles of Public Utility Rates 292 (1961). These criteria have been used by the Commission in previous cases and are again utilized here. (see, e.g., Order No. 2005-2 at 105 and 2003-38 at 76).

Once a utility's revenue requirement has been determined, a rate structure must be developed that yields that level of revenues. The basic objective of a rate structure is to enable a company to generate its revenue requirement without unduly burdening one class of customer to the benefit of another. Proper rate design results in revenues where each customer, and each customer class, pays, as close as practicable, the cost of providing service to them.

The Settlement Agreement provides for the agreed-upon increase in annual revenues of approximately \$118,622,000. The retail increases by customer class contained within the Settlement Agreement are as follows: 10.16% for the residential class, 6.42% for the general service class, 7.34% for the industrial class, and 4.32% for the lighting class. The primary

residential rate schedules, RE and RS, percentage increases includes ORS witness Seaman-Huynh's recommendation of increasing the Basic Facilities Charge by no more than \$1.00 from \$7.29 to \$8.29.

Company witness Gillespy testified that the Settlement Agreement reflects a constructive approach to providing necessary rate relief that will allow the Company to maintain its financial strength, credit quality, and continue to provide high quality electric utility service to its customers, while at the same time mitigating the impact of the rate increase on customers. The Settlement Agreement allows for an overall average net rate increase to Duke's customers of 8.16% effective September 18, 2013.

Company witnesses Bailey and Jones discussed the Company's processes for developing its rate proposals. Duke witness Jones prepared the cost of service studies that Bailey used as a major component for the rate design. The purpose of a cost of service study is to allocate the Company's revenues, expenses, and rate base among the regulatory jurisdictions and customer classes based on their service requirements.

The rates of return by class contained within the Settlement Agreement are as follows: 7.73% for the residential class, 8.19% for the general service class, 7.77% for the industrial class, and 8.66% for the lighting class. The overall rate of return for total South Carolina retail is 7.89%. ORS witness Seaman-Huynh testified that in developing the returns by class, ORS limited cross-subsidization of customer classes by employing a $\pm 10\%$ "band of reasonableness" relative to the overall retail rate of return. ORS was successful in bringing all the customer classes within this band. Company witnesses Bailey and Jones stated that once all costs and revenues are assigned, the study identifies the return on investment the Company earned during

the test year. These returns can then be used as a guide in designing rates to provide the Company an opportunity to recover its costs and earn its allowed rate of return in a fair and equitable manner across the classes of customers.

Company witness Bailey further testified that retail rates should produce rates of return among classes that bear a reasonable relationship to the Company's overall rate of return, and should provide movement toward equal rates of return among classes. The Commission is mindful of the implications of a rate increase on any class of customers, and also of the financial requirements of the utilities it regulates.

The evidence in support of the findings of fact are found in the verified Application, the Settlement Agreement, pleadings, testimony and exhibits in this Docket, and the entire record in this proceeding. Therefore, the Commission concludes that the proposed revenue increases and the respective rates of return by customer class as set forth in Settlement Agreement Attachment C represent an appropriate movement toward comparable returns, and bear a reasonable relationship to the Company's overall rate of return. As such, the proposed revenues and allocations are just, reasonable and supported by the evidence in the record.

IV. CONCLUSION AND ORDER

After hearing the testimony of the witnesses and based on the Commission's review of the Application, the Stipulation, the Settlement Agreement, and the testimony and exhibits submitted during the hearing, the Commission adopts as just and reasonable and in the public interest all terms and provisions of the Settlement Agreement as a comprehensive resolution of all issues. These include: (1) the accounting and pro forma adjustments appended to the Settlement Agreement in Attachment A; (2) base rates generating a revenue increase of

approximately \$118,622,000; (3) rates established based on a 10.20% ROE and a capital structure that includes 47% debt and 53% common equity; (4) at shareholder expense, a one-time contribution in the amount of \$3.5 million with \$1 million to be used under the direction of ORS to support public education initiatives and senior outreach, and \$2.5 million to be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs; and (5) adopting the proposed revenue increases by class and the respective rates of return in Settlement Agreement Attachment C. Lastly, the Company's services are adequate and are being provided in accordance with the requirements set forth in the Commission's rules and regulations pertaining to the provision of electric service.

IT IS THEREFORE ORDERED THAT:

1. The Settlement Agreement, which includes Settlement Agreement Attachments A, B, and C and adopts the Stipulation, entered into by the Settling Parties to this Docket is approved as just and reasonable in its entirety;
2. The calculation of the base rates required to generate approximately \$118,622,000 revenue increase shall be established based on a 10.20% ROE and a capital structure that includes 47% debt and 53% common equity;
3. Duke shall be allowed to increase revenues in the first year by \$80,391,000 or 5.53% and in the second year and beyond by an additional \$38,230,992 or 2.63%. For the two year incremental rate increase, rates would become effective no earlier than September 18, 2013 for the first year and September 18, 2014 for the second year;

4. The accounting and pro forma adjustments proposed by the Company in its Application, and in its testimony and exhibits filed in this proceeding, as modified by the changes in the Settlement Agreement Attachment A are approved;

5. Duke will not seek an increase in its retail base rates and charges to be effective prior to September 18, 2015, except for those approved as part of the Company's DSM rate rider and EE programs, or rates approved under Section 58-27-865, or the provisions of Article 4 of Chapter 33 of Title 58, or except where necessary due to unforeseen extraordinary economic or financial conditions;

6. Duke shall make, at shareholder expense, a one-time contribution in the amount of \$3.5 million with \$1 million being used under the direction of ORS to support public education initiatives and senior outreach, and \$2.5 million used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs;

7. The rate design and revenue allocation proposed by the Company in its Application, and in its testimony and exhibits filed in this proceeding, as modified by the changes agreed upon in the Settlement Agreement Attachment C, are approved;

8. The Settling Parties shall abide by all terms of the Settlement Agreement; and,

9. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

G. O'Neal Hamilton, Chairman

ATTEST:

Nikiya "Nikki" Hall, Vice Chairman